

ANALYSIS OF ORIGINAL BILL

Author: Kuehl Analyst: Colin Stevens Bill Number: AB 2692

Related Bills: See Legislative History Telephone: 845-3036 Introduced Date: 2-23-98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Depreciation Deduction/Ultra-Low Emission Vehicles Have a Class Life of 3 Years

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would provide that automobiles certified by the California Air Resources Board (CARB) as having emissions that meet or are lower than the standard for ultra-low emission vehicles (ULEV) would be depreciated over three years without regard to certain dollar limitations in the amount of depreciation that may be taken.

EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 1998, and before January 1, 2003.

SPECIFIC FINDINGS

Existing state and federal laws generally allow as a depreciation deduction a reasonable allowance for the exhaustion, wear, tear, and obsolescence of property used in a trade or business or property held for the production of income. Under existing federal law, taxpayers depreciate property using the Modified Accelerated Cost Recovery System (MACRS). MACRS lists 10 different cost recovery periods, ranging from 3 years to 50 years, depending on the type of property. The recovery period for automobiles and light general purpose trucks is five years under PITL and federal law.

California PITL has conformed to the federal MACRS system as in effect January 1, 1997. However, the B&CTL has not conformed to MACRS. The corporate depreciation deduction is instead based on the Class Life Asset Depreciation Range System (CLADR). The recovery period under the B&CTL is three years for automobiles and four years for light general purpose trucks.

Under federal law prior to January 1, 1997, and current PITL and B&CTL, the amount a taxpayer may claim as a depreciation deduction for any "luxury"

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X ___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO ___

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department Director Date
G. Alan Hunter 3/30/98

Agency Secretary Date

By: Date

passenger automobile is limited to: \$2,560 for the first taxable year, \$4,100 for the second, \$2,450 for the third and \$1,475 for each succeeding taxable year. Each dollar limitation is indexed for inflation after October 1987 by the automobile component of the Consumer Price Index.

New federal law in the Taxpayer Relief Act of 1997 (TRA) modifies the federal limitation on depreciation in the case of qualified clean-burning vehicles and certain electric vehicles built by an original equipment manufacturer by tripling the amount of depreciation that may be taken to \$7,680, \$12,350, \$7,350, and \$4,425, respectively. These amounts also are adjusted for inflation. Additionally, under the TRA passenger vehicles that initially use nonclean burning fuel, but are modified to permit propulsion by clean-burning fuel are not subject to luxury automobile depreciation limitations to the extent of the cost of the modifications. The rest of the vehicle's cost remains subject to the depreciation limitations described under luxury automobiles prior to the TRA's enactment.

California conforms to federal law as it read January 1, 1997, relating to depreciation of "luxury automobiles," but has not conformed to the changes made in 1997 with respect to clean-burning automobiles.

Under the PITL, **this bill** would provide that automobiles certified by the CARB as having emissions that meet or are lower than the standard for ULEVS would be depreciated over three years.

This bill would provide that the limitation on the maximum amount that may be depreciated in any one year would not apply to ULEVS under the PITL or the B&CTL.

Under the B&CTL, **this bill** also attempts to provide a three-year recovery period for light trucks. However, as noted later in this analysis, this bill seeks to modify portions of the IRC to which current state law does not conform.

Policy Considerations

This bill would create additional differences between federal and California tax law regarding depreciation, thereby increasing the complexity of completing a California tax return.

The bill applies to taxable or income years beginning on or after January 1, 1998, and before January 1, 2003. Under current federal and California law, the method of computing depreciation (including the determination of the applicable recovery period or class life) is made as of the date on which property is "placed-in-service" so that a single depreciation schedule is used for the life of the property. If the author intends the bill's provisions to apply to all ULEVs "placed in service" on or after January 1, 1998, and before January 1, 2003, then the bill will have to be amended to accomplish this intent. Department staff is available to assist the author's office with necessary amendments.

Implementation Considerations

Once the concern below is resolved, implementing this bill would require some changes to existing tax forms and instructions and information systems,

but would not significantly impact the department's programs and operations. Department staff is available to assist the author's office in resolving this concern.

To implement this bill the FTB would need certification by the CARB that a vehicle meets the standards for ULEVs. However, this bill does not require that: CARB provide to the FTB information regarding vehicles certified as meeting ULEV standards or provide a certification to taxpayers identifying a vehicle as a ULEV; taxpayers retain a certification of a vehicle as a ULEV; or taxpayers present any certification to the FTB upon request.

Technical Consideration

Under B&CTL, this bill attempts to shorten to three years the recovery period for ULEVs. However, since the B&CTL does not currently conform to IRC Section 168, this bill's attempt to modify portions of that section would have no effect. In order to apply to the B&CTL, either the B&CTL would need to conform to IRC Section 168 and adopt the modifications proposed in this bill, or stand alone language would need to be written. Department staff is available to assist the author's office with necessary amendments.

FISCAL IMPACT

Departmental Costs

If the implementation consideration is resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue losses under the B&CT and PIT law are estimated to be as follows:

Estimated Revenue Impact AB 2692			
Assumed Enactment After 6/30/98			
Fiscal Year Impact			
(In Millions)			
1998-9	1999-0	2000-01	2001-02
*(Minor)	(\$1)	(\$2)	(\$4)

* Less than \$500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Tax Revenue Discussion

This bill would decrease from five years to three years the amount of time required to depreciate qualified ULEVs. This revenue estimate assumes that the bill will be amended to allow B&CTL taxpayers to qualify for the accelerated three-year recovery period.

The revenue loss from this bill would depend on the number and qualified costs of ULEVs meeting reduced standards, and the amount of additional depreciation deduction in excess of the amount that would have been allowable under current law.

The estimated losses were determined in several steps. First, the total number of qualified ULEVs was based on information from CARB, news reports regarding agreements between automakers and CARB for the production and sales of zero emission vehicles, and various other articles regarding zero emission vehicles cost and production. CARB estimates that in fiscal year 1998-9 approximately 15,000 (60,000 in fiscal year 1999-0) new vehicles will be sold in California qualifying as ULEVs. Second, growth rates were based on annual percentage increases proposed by CARB to automakers for the sale of reduced emission vehicles. Third, after determining the number of qualifying vehicles, the following data and assumptions were used: (1) 25% of qualified sales would qualify for depreciation deductions (excluding government and exempt organizations); (2) the average cost of a qualified vehicle is estimated to be approximately \$30,000; and (3) an average marginal tax rate of 8% was used.

BOARD POSITION

Pending.